



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Release Number: **201051024**
Release Date: 12/23/10
Date: September 27, 2010
UIL Code: 512.00-00

Contact Person:
Identification Number:
Contact Number:
Employer Identification Number:
Form Required To Be Filed:
Tax Years:
All Years

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: July 9, 2010

UIL Code: 512.00-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

M =

N =

X =

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

FACTS:

You were incorporated under the nonprofit laws of the state of M on x. According to your Articles of Incorporation your purpose is to advance the religious beliefs, cultural traditions and lifestyles of four N churches (the "churches") by providing loans and other assistance for real estate purchases and other farm and business related purchases to members of the churches; to encourage savings and thrift and continue to be committed to Christian principles of operation by providing investment and borrowing opportunities to enhance economic social and spiritual well being of the N Brotherhood; and to operate exclusively for charitable, religious or educational purposes.

You are governed by a seven-member board which was selected from the membership of the churches. Nominees for vacant positions on your board will be selected by your existing board members and elected by your investors.

You will operate as a nondepository financial institution which provides loans but will not operate savings accounts or other depository accounts.

You were formed primarily to offer low interest loans to eligible individuals and organizations and to provide investment opportunities to eligible individuals.

You will limit eligibility for loans to the members of the churches, organizations whose principals are such persons and nonprofit organizations that draw substantial support from among members of the churches. The total membership of the churches is approximately _____. You state that you do not target a specific group of people within the churches, such as the needy.

Potential borrowers will submit a loan application as well as a loan worksheet. The loan application requires, among other things, a list of the assets and liabilities of the potential borrower and a statement describing what the loan will be used for and how it will be repaid. The monthly payment with respect to loans cannot exceed 1/3 of a borrower's monthly income. Loans will be limited to _____ % of the collateral provided. You will hold title to collateral until the loan is paid in full. The interest rate on loans is the *Wall Street Journal* prime rate minus _____. Interest rates are adjusted quarterly. Loans will be amortized up to 20 years for real estate, up to 10 years for business loans and up to 5 years for operating loans. No borrower may borrow more than _____ % of your assets. In addition to servicing the loans you make, you will review and service "pass-through" loans, loans between individual members of the churches.

Loan applications will be reviewed by a three-person credit committee. Credit decisions will be based on the committee's assessment of a borrower's ability and willingness to repay and any arrangements made for additional accountability. You state that although the majority of the loans you make will use standard measures of creditworthiness, loans may also be available to individuals who agree to allow a three-man committee to assist them with financial management decisions. Such loans will be made on a case-by-case basis. You state that you do not anticipate making loans to members of your governing board.

You indicate that you will make approximately 20 to 30 loans annually. In response to Item 6 of our letter dated November ___, 20___ concerning the number of individuals eligible to apply for loans annually you state, "Members of served churches, approximately 400. If [your] operations are successful within the initially served churches and the served population is broadened to other churches in M, this could expand substantially in the future."

Investors are limited to residents of M who are members of the churches. Eligible individuals meeting the minimum-investment requirement (\$10,000), up to a maximum of 25 new investors annually (to comply with the requirements for exemption from the security laws of the state of M), will be accepted on a first-come, first-serve basis. No investor may provide more than _____ % of your total assets. The interest rate on investments is the *Wall Street Journal* prime rate minus _____. Interest rates are adjusted quarterly. Interest payments are made semi-annually.

You state that both your lending and borrowing activities will support your exempt purpose of advancing your religious beliefs, cultural traditions and lifestyles of the churches. You represent that central to your religious doctrine is a belief (i) in Biblical financial truths, including brotherly financial aid, responsibility for stability in family finances, the collective responsibility for all members of the church for each other's well being and personal stewardship and (ii) that deacons of your churches are called by God to oversee and, where applicable, alleviate the financial hardship of their church's members. You state that all of these principles lead to the rejection of laws that permit or facilitate the avoidance of responsibility, such as bankruptcy and insolvency laws. You represent that many secular investment opportunities such as insured savings plans and annuities provide forms of insurance which conflict with some church members' perception of what their faith requires of them. By providing investment and lending opportunities, you indicate that you will allow church members to avoid insurance provided with certain investment opportunities and to avoid the requirements to obtain commercial fire insurance, life insurance, etc. when borrowing funds.

You currently have no educational activities. You indicate that, in the future, you plan to lend and sell material which helps people live from contentment rather than defining themselves by their material acquisitions and to recognize God as the true owner of all resources. You may also offer classes progressing through a financial management series and a course emphasizing a Christian ethic of business and money. These activities will constitute an insubstantial part of your overall activities.

Although you were initially funded by contributions from founding board members and received a church offering from each of the churches, you do not plan to engage in further fundraising activities. Your primary method of raising capital will be interest bearing loans from investors. Your sole source of income will be interest charged to borrowers. You plan to use the spread between the interest rates paid to investors and those charged to borrowers to pay all necessary future expenses.

In support of your position that you qualify for exemption, you cite Rev. Ruls. 65-299, 1965-2 C.B. 165, 74-575, 1974-2 C.B. 161, 75-282, 1975-2 C.B. 201, 75-343, 1975-2 C.B. 205 and 79-359, 1979-2 C.B. 226. Further you cite *World Family Corp. v. Commissioner (World Family Corp.)*, 81 T.C. 958, 963 (1983).

LAW:

Section 501(c)(3) of the Code provides, in part, for exemption from federal income tax of organizations organized and operated exclusively for charitable, religious or educational purposes, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both

organized and operated exclusively for one or more purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(b) of the regulations provides that to meet the organizational test an organization must meet three sets of requirements. First, its articles of organization must (a) limit its purposes to one or more exempt purpose and (b) not expressly permit substantial activities that do not further those exempt purposes. Second, its articles must not expressly permit (a) substantial lobbying, (b) any participation in the campaign of a candidate for public office, and (c) objectives and activities that would characterize it as an "action" organization. Third, its assets must be irrevocably dedicated to exempt purposes.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Section 1.501(a)-1(c) of the regulations defines private share holder or individual as a person having a personal and private interest in the in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Therefore, to meet the requirement of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the relief of the poor and distressed or the of the underprivileged; advancement of religion; and, advancement of education or science.

Rev. Rul. 69-175, 1969-1 C.B. 149, held that a nonprofit organization, formed by parents of pupils attending a private school, that provides school bus transportation for its members' children, serves a private rather than a public interest and does not qualify for exemption under section 501(c)(3) of the Code. When a group of individuals associate to provide a cooperative service for themselves, they are serving a private interest. The organization enables the participating parents to fulfill their individual

responsibility of transporting their children to school. Thus, the organization serves a private rather than a public interest. Accordingly, it is not exempt from federal income tax under section 501(c)(3).

Rev. Rul. 70-186, 1970-1 C.B. 128, describes an organization formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features. Although the organization clearly benefited the public, there necessarily was also significant benefit to the private individuals who owned lake front property. The revenue ruling held that the private benefit was incidental to the accomplishment of the organization's exempt purpose. The benefits to be derived from the organization's activities flowed principally to the public. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

In contrast, Rev. Rul. 75-286, 1975-2 C.B. 210, describes an organization formed by the residents of a city block to preserve and beautify that block. Its activities consist of paying the city government to plant trees on public property within the block, organizing residents to pick up litter and refuse in the public streets and on public sidewalks within the block, and encouraging residents to take an active part in beautifying the block by placing shrubbery in public areas within the block. Membership in the organization is restricted to residents of the block and those owning property or operating businesses there. The revenue ruling concluded that the organization did not qualify for exemption under section 501(c)(3) because it operated to serve private interests by enhancing members' property rights.

Rev. Rul. 72-369, 1972-2 C.B. 245, held that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations did not qualify for exemption under section 501(c)(3) of the Code. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

In Bethel Conservative Mennonite Church v. Commissioner, (“Bethel Conservative Mennonite Church”) 746 F.2d 388 (7th Cir. 1984), nonacq. AOD CC-1986-004, the court held that the church's medical aid plan, funded by contributions and available to all members of the congregation in good standing and their dependents, furthered the religious purposes of the organization.

In *Mutual Aid Association of Church of the Brethren v. U.S.*, (“Mutual Aid Association”) 759 F.2d 792 (10th Cir. 1985), the Court of Appeals held that an organization providing property and casualty insurance for members of the Church of the Brethren on the basis of assessed premiums is not primarily engaged in the promotion of the social welfare for exemption under section 501(c)(4) of the Code. The organization argued that its activities advance the religious principles of the Church of the Brethren and that it carries out only the historical and doctrinal practice of mutual aid, a practice

fundamental to the concepts of the Brethren Church. The court addressed this contention thus, "Certainly MAA was formed and promoted by church members and limits its policy sales to church members. But MAA does not give succor to souls; it sells insurance coverage." The court concluded that the presence of a substantial non-exempt purpose, insurance for its members in return for premiums, precluded the organization's exempt status.

In *American Association of Christian Schools Voluntary Employees Beneficiary Association Welfare Plan Trust v. U.S.*, 850 F.2d 1510 (11th Cir. 1988) ("*American Association*"), the American Association of Christian Schools, Inc., a tax-exempt association of churches, formed a trust to provide health, hospital, disability, life, accidental death and dismemberment, dental and prescription drug insurance to employees of members' schools and their dependents and beneficiaries. Citing *Mutual Aid*, *supra*, the Court of Appeals concluded that the Trust was not exempt under section 501(c)(3) because it was not operated exclusively for religious purposes; it had a substantial private, non-exempt purpose of providing insurance protection to participating employees.

Living Faith, Inc. v. Commissioner, 950 F.2d 365 (7th Cir. 1991) ("*Living Faith, Inc.*"), involved an organization established by the Seventh-day Adventist Church to carry out religious purposes in keeping with the doctrines of the Seventh-day Adventist Church, including its "health ministry" through operation of two vegetarian restaurants and health food stores. The Court of Appeals sustained the Service's denial of tax exemption under section 501(c)(3) of the Code because the organization was operated for a substantial non-exempt commercial purpose. The court found that the organization's activities were "presumptively commercial" because the organization was in competition with other restaurants, engaged in marketing and generally operated in a manner similar to commercial businesses.

In *B.S.W. Group, Inc. v. Commissioner of Internal Revenue*, 70 T.C. 352 (1978) ("*B.S.W. Group*"), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily carried on by for-profit commercial businesses. The Tax Court stated, "We must agree with the Commissioner that petitioner's activity constitutes the conduct of a consulting business of the sort which is ordinarily carried on by commercial ventures organized for profit. . . .".

In *Better Business Bureau of Washington D.C. Inc. v. United States*, 326 U.S. 279, 66 S. Ct. 112, 90L. Ed. 67, 1945 C.B. 375 (1945) (*Better Business Bureau, Inc.*"), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

ANALYSIS:

Organizational Test:

Section 1.501(c)(3)-1(b) of the regulations provides in part that to meet the organizational test an organization's articles of organization must, limit its purposes to one or more exempt purposes.

Articles 4(a) and (b) of your Articles of Incorporation states that you were formed to provide investment and borrowing opportunities. Providing investment and borrowing opportunities to members is not an exempt purpose described in section 501(c)(3). Accordingly, you do not meet the organizational test described in section 1.501(c)(3)-1(b) of the regulations.

Operational Test:

Operation of a Trade or Business:

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Your primary purpose is to operate a trade or business, a lending institution which directly competes with commercial lending institutions. Your business practices are consistent with those of the industry in general. You will be funded by capital from investors. Your method of determining fees is similar to the method used by commercial lending institutions. The interest on your loans will be set at a level sufficient to cover your operating costs. Borrowers must provide financial information evidencing that they are creditworthy and have the financial means to repay the loans. The loans may not exceed 80% of collateral provided. The interest rates, payment periods and length of the loans are substantially similar to those of commercial lending institutions. Your sources of support will be limited to interest from loans and service fees for managing loans directly between members. You have no plans to solicit contributions in the future. You represent that, if successful, you plan to expand your operations substantially.

In *Bethel Conservative Mennonite Church*, supra, the court held that the church's medical aid plan, which was funded by contributions rather than premiums, furthered the religious purposes of the organization. However, as noted above, the Service has indicated that it will not follow the Court's decision. In any event, your activities are distinguishable from those of Bethel Conservative Mennonite Church since you are

funded by income generated by your operation of a trade or business rather than by voluntary contributions.

The Eleventh Circuit held in *American Association*, supra., a trust formed to provide insurance to employees of members' schools was not exempt under section 501(c)(3) because it was not operated exclusively for religious purposes; it had a substantial private, non-exempt purpose of providing insurance protection to participating employees. See also, *Mutual Aid Association*, supra., in which the Tenth Circuit upheld the Service's denial of section 501(c)(4) status to an organization providing the equivalent of property insurance protection available only to members of the church. In *Mutual Aid Association* the organization argued that the provision of mutual aid was fundamental to the concepts of the church. Like the organizations described in *American Association* and *Mutual Aid Association*, although you were created with religious principles in mind, your primary purpose is the operation of a trade or business. See also *Living Faith, Inc.*, *B.S.W. Group*, and Rev. Rul. 72-369, all supra.

Precedents you cited in support of your position:

In support of your position that you qualify for exemption, you cite Rev. Ruls. 65-299, 74-575, 75-282, 75-343 and 79-359, all supra. These revenue rulings are not relevant.

Rev. Rul. 65-299, supra., concerned exemption under section 501(c)(4). The organization promoted social welfare by educating and assisting consumers with credit problems. You are not seeking exemption under section 501(c)(4). Even if you were, unlike the organization described in the revenue ruling, your primary purpose is not educational. Further, the revenue ruling specifically states that no loans were made to the individuals seeking assistance. Your primary purpose is to make loans to individuals.

Rev. Rul. 75-282, supra., concerned an organization formed to make loans to a conference of churches. The basis for that ruling was that the organization operated as an integral part of the conference of churches and making loans to member churches to build church facilities furthered the exempt purposes of the conference of churches. You make loans to individuals, not churches. Further, rather than being used to build church facilities, your loans are for the personal use of the church members.

Rev. Rul. 75-343, supra., concerned the provisions of section 3122 of the Federal Insurance Contributions Act. Thus, it is not relevant to your situation.

Although Rev. Ruls. 74-575 and 79-359 refer to religious purposes with respect to supervision and inspection of commercially prepared food and burial services, respectively, the court cases cited above, *American Association*, *Mutual Aid Association*, *Living Faith, Inc.* and *B.S.W. Group*, all supra. are more recent and more relevant to your operations.

In I.R.B. 1985-1, 5., the Service issued a notice of its nonacquiescence respect to *World Family Corp.*, supra. In any event, you do not operate in a manner similar to the organization described in that court case. The organization in *World Family Corp.* made grants and interest free loans to missionaries. Unlike that organization, you are making interest bearing loans to individuals to build homes or support the businesses they operate.

Substantial Private Benefit:

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Therefore, to meet the requirements of this subsection, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

You were formed to operate a lending institution. The investment opportunities with respect to the institution are limited to members of the churches. Loans will be made solely to church members, organizations whose principals are church members and to nonprofit organizations that draw substantial support from among church members.

Like the organizations described in Rev. Rul. 69-175, supra, and Rev. Rul. 75-286, supra, which benefited specific individuals rather than the public, your operation of a lending institution providing investment opportunities and loans to church members serves a private rather than a public interest. Unlike the organization described in Rev. Rul. 70-186, supra, formed to preserve a lake as a public recreational facility, you were formed primarily to benefit to your investors and borrowers.

Substantial Non-exempt Purpose:

Qualification for exemption under section 501(c)(3) of the Code requires, inter alia, that an organization operate exclusively for exempt purposes. Exclusivity with respect to section 501(c)(3) does not mean "solely" or "without exception," but rather contemplates that any non-exempt activities be only incidental and less than substantial. See section 1.501(c)(3)-1(c)(1) of the regulations.

This requirement is affirmed in *Better Business Bureau, Inc.*, supra, where the court held that the presence of a single non-exempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of truly exempt purposes. Thus, if an organization engages in a substantial non-exempt activity, it does not meet the operational test of section 501(c)(3) of the Code, regardless of how substantial its religious or other exempt activities are.

We have concluded that you are not operated exclusively to promote religion under section 501(c)(3) of the Code, or to further any other tax-exempt purpose within the meaning of section 501(c)(3) and section 1.501(c)(3)-1(d) of the regulations. You were formed primarily for the non-exempt purpose of operating a lending institution, a trade or business of the type ordinarily carried on for profit. Further, your activities result in a substantial private benefit to your investors and borrowers.

CONCLUSION:

Because you are neither organized nor operated exclusively for exempt purposes, you do not qualify for exemption under section 501(c)(3) of the Code.

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

Your protest statement should be accompanied by the following declaration:

Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, Power of Attorney and Declaration of Representative, if you have not already done so. For more information about representation, see Publication 947, Practice before the IRS and Power of Attorney. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert Choi
Director, Exempt Organizations
Rulings & Agreements